United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

ORIGINAL

77-5036

To be argued by
LEWIS KRUGER

B

P/S

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

In Re

EASTERN FREIGHT WAYS, INC.,

Bankrupt,

SIDNEY B. GLUCK, Trustee in Bankruptcy of EASTERN FREIGHT WAYS, INC.,

Plaintiff-Appellee,

against

SEABOARD SURETY COMPANY,

Defendant-Appellant,

MANUFACTURERS HANOVER TRUST COMPANY, individually and as agent for other institutional lenders, INTERNATIONAL HARVESTER CREDIT CORPORATION, FRUEHAUF CORPORATION and THE CHASE MANHATTAN BANK, NATIONAL ASSOCIATION, and THOMAS J. CAHILL, Trustee in Bankruptcy of ASSOCIATED TRANSPORT, INC.,

Defendants-Appellees.

UNITED STATES COURT OF APPEALS
FILED
DEC 28 1978
SECOND CIRCUIT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANT-APPELLEE INTERNATIONAL HARVESTER CREDIT CORPORATION

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BRIEF OF DEFENDANT-APPELLEE INTERNATIONAL HARVESTER CREDIT CORPORATION

Preliminary Statement

This brief is submitted on behalf of defendant-appellee International Harvester Credit Corporation ("Harvester Credit") which has a security interest in the accounts receivable of Eastern Freight Ways, Inc., bankrupt ("Eastern"), in opposition to the appeal of defendant Seaboard Surety Company ("Seaboard") from the order of United States District Court Judge Edmund L. Palmieri, dated October 31, 1977, affirming the order of Bankruptcy Judge Roy Babitt, entered May 27, 1977, which denied Seaboard's motions (i) to dismiss the complaint of the Eastern Trustee in Bankruptcy alleging improper acts and claims of setoff by Seaboard and requesting declaratory and injunctive relief, (ii) to dismiss the cross-claims of certain defendants and (iii) to award affirmative relief to Seaboard.

Issues Presented

1. Whether a surety, in possession of $2,000,000 security from its bankrupt principal, has a right to set off the principal's accounts receivable against cargo claims of shippers in disregard of the existence of the security.

2. Whether the Bankruptcy Court, in the proper exercise of its jurisdiction over a claim that a cargo loss surety can set off the bankrupt principal's accounts receivable against the shipper-creditors' loss claims is required to consider the surety's possession and application of $2,000,000 security in establishing whether the surety is entitled to a setoff on the accounts.

Counterstatement of the Case

The Proceeding

This is an adversary proceeding commenced in the Bankruptcy Court, with the consent of all the parties (R 131a, LL. 16-25; 132a, LL. 1-6), by the Eastern Trustee for the purpose of resolving issues initially raised by Seaboard's application to the Bankruptcy Court on June 25, 1976 for an order requiring the receiver in bankruptcy of Eastern and its affiliated company Associated Transport, Inc. ("Associated"), to turn over to Seaboard all of the accounts receivable records of Eastern and Associated. (R 28a et seq.) In this adversary proceeding, the Trustee seeks injunctive and declaratory relief with respect to rights of setoff asserted by Seaboard to the Eastern accounts receivable and to establish the threshold at which Seaboard's rights, if any, to the accounts receivable shall commence, in view of the fact that Seaboard has available the proceeds of a $2,000,000 letter of credit to satisfy creditors. Harvester Credit seeks injunctive and declaratory relief and damages from Seaboard for interference with and destruction of Harvester Credit's collateral.

The Facts

The facts for purposes of this appeal are not necessarily the facts which would govern had there been a full hearing at which evidence was adduced. No such hearing has been held. At the present time, many of the "facts" alleged by Seaboard and others are not truly facts established by competent evidence in the proceeding before the Bankruptcy Court, but are merely lawyers' allegations unsubstantiated by any hard evidence subjected to examination or cross-examination. The relevant circumstances which Harvester Credit believes to be correct and controlling of this appeal are the following:

1. Seaboard issued cargo bonds to the ICC on behalf of Eastern and its affiliated company Associated in September, 1974. (R 355a)

2. In connection with the issuance of the bonds, Seaboard entered into agreements with Eastern and Associated known as the "Collateral Agreement" and the "General Agreement of Indemnity" in August and September, 1974. (R 356a-67a)

3. Seaboard negotiated for and accepted a $2,000,000 letter of credit issued by defendant Chase Manhattan Bank, N.A. ("Chase") to Seaboard on behalf of Eastern alone (R 269a),

4. The Collateral Agreement and the General Agreement of Indemnity set forth, in identical language, the scope of those agreements (R 359a; 363a):

> "WHEREAS, at the request of Indemnitors or principal, or anyone, some or all of them, Surety has executed or procured or may hereafter execute or procure the execution, renewal, continuation, or extension of bonds, undertakings or recognizances (hereinafter called 'Bond' or 'Bonds') as may be required from time to time by Indemnitors, or any one, some or all of them, either in the name of the Indemnitors, or any one, some or all of them, or some other person, firm or corporation to be designated by the Indemnitors, or any one, some or all of them, or for any subsidiary or affiliated person, firm or corporation which Indemnitors or any one, some or all of them, now or hereafter may own, control or operate, and *specifically on behalf of:*
>
> *Eastern Freightways, Inc. and/or Associated Transport, Inc. and/or any of its or their divisions, and/or any subsidiary corporation, corporations or interests now existing or hereinafter existing or acquired,*
>
> or any of them or any combination of them (herein called "Principal") a copy or copies of which may hereto be attached." (Emphasis added.)

5. By contrast, the letter of credit refers only to Eastern (R 269a):

> "We hereby authorize you to draw on the Chase Manhattan Bank, N.A., New York, New York, by Order of the Chase Manhattan Bank, N.A., branch #26 (Pennsylvania Branch) and for the account of Eastern Freightways, Eastern and Moonachie Avenues, Calstat, New Jersey, 07022, up to an aggregate amount of $2,000,000 U.S. Dollars, available by your drafts at sight acompanied by *your written certification that you have not been released from liability under the surety bond(s) or undertaking(s) you have executed on behalf of Eastern Freightways, Inc.*" (Emphasis added)

6. The factual circumstances under which the letter of credit issued and was drawn upon will become important in the litigation subsequent to this appeal, though the question has not yet been litigated and is not directly at issue on this appeal. Seaboard claims the Eastern letter of credit was obtained pursuant to the Collateral Agreement and the proceeds are available to indemnify Seaboard for shippers' claims against both Eastern and Associated. (R 356a, ¶ 7) The appellees' position is that the letter of credit must be interpreted in accordance with its terms. (R 266a, ¶ 47) Whatever the facts and the legal conclusions ultimately drawn from those facts, it is sufficient for the purposes of this appeal to recognize as a fact that there is a sum of money in Seaboard's hands as indemnification to Seaboard for claims from Eastern's shippers.

7. Thereafter, in 1975, Eastern granted to Manufacturers Hanover Trust Company, and thereafter to Harvester Credit, among others, for valuable consideration, security interests in and to its accounts receivable, among other assets. (R 260a, ¶ 18)

8. Eastern and Associated filed for relief under Chapter XI of the Bankruptcy Act on April 22, 1976. Each of them was adjudicated a bankrupt on April 28, 1976 and a single receiver was appointed to administer both estates.

9. Seaboard thereupon, on April 28, 1976, took down the full proceeds of the $2,000,000 letter of credit (R 357a, ¶ 11).

10. In both the Chapter XI proceedings and the subsequent bankruptcy, the Bankruptcy Court granted authority to continue the operation of the respective businesses and freight was carried until approximately May 15, 1976 under the bonds.

11. On June 25, 1976, Seaboard appeared in the Bankruptcy Court requesting that the accounts receivable records of Eastern and Associated be turned over to Seaboard. Such relief was denied. (R 28a et seq.)

12. In August 1976, without notice to the Eastern Trustee or the Bankruptcy Court, Seaboard sent a letter to certain cargo claimants who were account receivable debtors of Eastern and Associated. The Seaboard letters notified cargo loss claimants that Seaboard would require a setoff and would pay only the excess remaining after the claimant had set off the loss claim against its debt to the bankrupt. The letter is reproduced at R 271a.

13. The Seaboard letter was different in form from the letter described *In re Yale Express,* 362 F.2d 111 (2d Cir. 1966), which according to the brief of F. Ralph Nogg filed in connection with that case, read as follows:

> "We call your attention to Section 68A of the Bankruptcy Act:
>
> > 'In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor, the account shall set off the other, and the balance only shall be allowed and paid.'

"In our opinion, cargo claims and freight bills accruing prior to the filing of the petition may be set off against each other. May we have your further advice in this regard."

(Quoted in brief of Appellee, F. Ralph Nogg, Trustee in Bankruptcy of Yale Express Systems, Inc. and subsidiaries filed in the Yale Express case, *supra.*)

14. Thereafter, the Trustee, Seaboard, Harvester Credit and others commenced and participated in a litigation process in the Bankruptcy Court consisting of applications, conferences and hearings, in the course of which Seaboard asserted affirmative claims and agreed to resolve disputes with the Trustee and Harvester Credit among others in the Bankruptcy Court.

15. Thereafter, upon commencement of the intended adversary proceeding, Seaboard asserted that it had not consented to jurisdiction, and, that if it had so consented such consent was now withdrawn, and moved to dismiss part of the proceeding for lack of jurisdiction and the balance for failure to state a claim. At the same time, Seaboard asked for affirmative relief.

Those are the relevant facts on this appeal.

Prior Proceedings

Nearly five months of applications for various relief, and conferences and hearings before the Bankruptcy Court resulted in universal consent that the related rights and obligations at issue must be determined in one litigation in one forum. (R. 123a, LL. 24-25 through 124a, LL. 1-8; 128a, L. 25 through 129a, LL. 1-25; 131a, LL. 21-25 through 132a, LL. 1-5; 158a, LL. 19-25 through 159a, LL. 1-22; 240a, LL. 19-25 through 241a, LL. 1-10; 250a, LL. 16-25). Though the complaint in this adversary proceeding was served in November, 1976 by the Eastern Trustee, the various issues

addressed in the complaint first received the attention of the Bankruptcy Court in June 1976, when Seaboard by order to show cause, applied to the Bankruptcy Court to have the Eastern and Associated accounts receivable records turned over to it. (R 28a et seq.) Seaboard's application was denied, but Seaboard's subsequent August, 1976 letter to cargo claimants with respect to the accounts receivable caused the Trustee to request, and obtain, from the Bankruptcy Court a temporary restraining order prohibiting Seaboard from interfering with the administration of the Eastern estate by inviting setoffs against the accounts receivable, at least until such time as Seaboard's rights to such setoffs, if any, were established. (R 132a-33a)

Harvester Credit and Manufacturers Hanover Trust Company joined in and, by consent, proceeded on the Trustee's papers in seeking the restraining order.

The questions underlying Seaboard's unilateral attempts to benefit from the Eastern accounts receivable, without reference to the rights of secured creditors, other claims or the proper administration of the estate, include the availability of Seaboard's drawdown of and the propriety of the application of the $2,000,000 letter of credit proceeds furnished by Eastern as collateral security to Seaboard.

Realizing that resolution of Seaboard's rights with respect to the accounts receivable, if any, could not be determined in the absence of a decision with respect to the letter of credit proceeds, the parties agreed to submit the dispute to the Bankruptcy Court in an adversary proceeding.

Seaboard responded to the three causes of action set forth in the complaint by moving to dismiss the complaint (i) as to the first two causes of action, grounded in Seaboard's claims to the accounts receivable, for failure to state a claim on which relief could be granted, and (ii) as to the third cause of action, grounded in the letter of

credit, for lack of summary jurisdiction. Seaboard, at the same time, requested affirmative relief authorizing the accounts receivable setoff first asserted by Seaboard on its initial appearance in the Bankruptcy Court. The defendants, except for the Associated Trustee, cross-claimed seeking affirmative and declaratory relief against Seaboard in connection with Eastern's accounts receivable based on Seaboard's duties arising from the transactions resulting in the letter of credit proceeds. The Associated Trustee requested declaratory relief only in connection with the letter of credit proceeds.

The Bankruptcy Court granted Seaboard's motion to dismiss the Trustee's second cause of action and denied Seaboard's motions in all other respects, stating: "The existence of the proceeds of the letter of credit is a matter which is crucial to the determination of the request for affirmative relief that Seaboard, by its own motion, places before the court" (R 538a), and holding that Seaboard is required to exhaust the letter of credit proceeds before it can claim a right of set-off against Eastern's accounts receivable. The Bankruptcy Court made permanent the injunction restraining Seaboard from interfering with the administration of the estate (in particular, the sending of unsupervised letters inviting setoffs to cargo claimants); ordered Seaboard to render an accounting for receivables thus far set off, and recognized that all of the other issues in the proceeding must await an evidentiary hearing.

The District Court, on Seaboard's appeal from the Bankruptcy Court's order, affirmed the Bankruptcy Court's order in all respects.

ARGUMENT

POINT I

The Bankruptcy Court properly held and the District Court properly affirmed that in the exercise of its jurisdiction over accounts receivable of the Bankrupt, Eastern, the setoff claims asserted by the surety must be determined in light of the existence and valuation of the $2,000,000 letter of credit proceeds.

Both the District Court and the Bankruptcy Court gave the facts and the equities in this proceeding close analysis and exhaustive discussion in view of Seaboard's insistence that *In re Yale Express,* 362 F. 2d 111 (2d Cir. 1966), is the controlling authority. Both concluded that the rationale of *Yale Express* did not apply to the facts in this case, and Seaboard should not as a matter of law be permitted, without more, to require setoffs of shippers' lost cargo claims against the shippers' debts to Eastern because Seaboard could not claim, as could the surety in *Yale Express,* that its principal's estate was being enhanced at the surety's expense.

It is telling that Seaboard, in casting about to resemble the surety in *Yale Express* does not attempt in Point I of its Brief to account for the equities emphasized by the courts below in this proceeding and by this Court in *Yale Express.* It speaks only of the inflexible and unqualified "right" of a surety of an insolvent debtor to the setoff permitted in *Yale Express,* as though any court would blindly apply an equitable rule without closely examining the context and the rights of all parties affected.

The inference to be drawn from Point I of the Appellant's Brief is that Seaboard negotiated and received a $2,000,000 letter of credit issued on behalf of Eastern; drew down the proceeds, but never intended to use them to pay

shippers' claims. The *only* reference to the letter of credit in Point I of Seaboard's brief is a somewhat smug one urging that Seaboard does not give up its right to *Yale* set-offs because it had the foresight to insist on security. Surely, equity does not countenance a surety which is exonerated in advance by its principal and then insists that its principal pay the debt the surety has undertaken.

Indeed, that is contrary to the standards, set forth by Judge Friendly in *Yale Express,* to be met by a surety which is permitted to assert its creditor's claim. In order to prevail, the surety had to establish:

> "(1) That it stood as a surety for Yale with respect to the claims here in question;
>
> (2) That as a surety it was equitably entitled to require deduction of freight owing to Yale;
>
> (3) That this equitable right should be recognized in bankruptcy; and
>
> (4) That enforcement of the right would not unduly interfere with the rehabilitative objective of the Chapter X proceeding." 362 F. 2d at 114.

Seaboard, in its Brief (at p. 13) sets out the four standards in full and then comments disingenuously:

> "It is significant that Judge Friendly did not list a fifth requirement to the effect that [the surety] have no recourse against Yale's trustee."

As both the Bankruptcy Court and the District Court recognized, the surety's lack of recourse in *Yale Express* is the rationale underlying the holding of the case. That Seaboard not only has recourse against the Eastern Trustee, but holds the letter of credit proceeds constituting recourse in its possession, is the fact that most compellingly distinguishes this case from *Yale Express* and bars Seaboard from claiming, until it no longer has such re-

course, "that as a surety it [is] equitably entitled to require deduction of freight owing to [Eastern]."

The discussion of recourse or lack of recourse is but another way of phrasing the equitable principles courts have always applied to suretyship and subrogation. Seaboard has not cited a single precedent, nor is it likely to find one, where a court of equity subrogates a surety, who can be made whole, to the creditor's claim against the principal when the surety has not paid the creditor.

Seaboard's setoff and subrogation claims, if any, are preserved by Sections 1(28), 57(e), 57(h), and 57(i) of the Bankruptcy Act (11 U.S.C.A. §§ 1(28), 98(e), 98(h) and 98(i) and Bankruptcy Rule 306(d).

Section 57(e) provides:

> "Claims of secured creditors and those who have priority may be temporarily allowed to enable such creditors to participate in the proceedings at creditors' meetings held prior to the determination of the value of their securities or priorities, but shall be thus temporarily allowed for such sums only as to the courts seem to be owing over and above the value of their securities or priorities."

Section 57(h) provides:

> "The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, *as the court may direct,* and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court." (emphasis supplied)

Section 57(i) provides:

> "Whenever a creditor whose claim against a bankrupt estate is secured, in whole or in part, by the individual undertaking of a person, fails to prove and file that claim, that person may do so in the creditor's name, and he shall be subrogated to the rights of the creditor, whether the claim has been filed by the creditor or by him in the creditor's name, *to the extent that he discharges the undertaking* except that in absence of an agreement to the contrary, he shall not be entitled to any dividend until the amount paid to the creditor on the undertaking plus the dividends paid to the creditor from the bankrupt estate on the claim equal the amount of the entire claim of the creditor. Any excess received by the creditor shall be held by him in trust for such person." (emphasis supplied)

Section 1(28) of the Bankruptcy Act includes, in the definition of "secured creditors", a creditor for whose debt a surety has security.

To the extent that Seaboard's security in the letter of credit proceeds may prove to be insufficient, Sections 57(e), 57(h) and 57(i) permit the Bankruptcy Court to subrogate Seaboard and make that determination and to allow a claim for the balance.

Sections 57(e) and 57(h), however, most clearly do *not* provide for Seaboard to make that determination itself, or to require or invite account debtors to do so or in any other fashion to take the administration of Eastern's assets into its own hands by unilaterally excluding the security it holds from the determination of allowable claims against the estate.

Section 57(i) is the statutory statement of the "general rule" of subrogation for which *Yale Express* is the exception. Seaboard's lengthy discussion of Section 57(i) to

instruct the Court on rights of subrogation fails to take into account that Seaboard is a surety desiring a Section 57(i) subrogation *without* discharging its undertaking to the creditors when it has the means to do so.

Judge Learned Hand first articulated the rationale for *Yale Express* in *U. S. ex rel. Johnson* v. *Morley Const. Co.*, 98 F. 2d 781 (2d Cir. 1938):

> ". . . the upshot of denying the surety a right to assert the counterclaim [of the creditor where the surety has no other source of compensation from the principal] is to enhance the principal's estate *at the expense of the surety,* which is contrary to the fundamental relation between the two." (emphasis supplied) 98 F. 2d at 790.

In *Meeker* v. *Halsey,* 87 F. 2d 299 (2d Cir. 1937), cited by both the Bankruptcy Court and the District Court as the general rule for setoffs as it is so described in *Morley,* Judge Hand, in apt dictum, described a case where the creditor was allowed to collect the debt from the principal, though the surety had already paid it, stating:

> ". . . (that) doctrine . . . must stand on the theory that the creditor may constitute himself a trustee of the proceeds for the surety. It would be a perversion of such a doctrine to allow the creditor to collect from the surety after the principal had paid; he could neither recover the same debt twice for himself, nor make himself a trustee for the principal of proceeds collected from the surety." 87 F. 2d at 301.

Allen v. *See,* 196 F. 2d 608 (10th Cir. 1952), cited by Seaboard as an instance of the surety's unqualified right of subrogation, is another case where a guarantor was permitted to assert the creditor's claim *after* the guarantor had paid the debt and was within Section 57(i) of the Bankruptcy Act.

Seaboard's suggestion at p. 12 of its Brief, that Judge Friendly, in *Yale Express,* relied on the reasoning of Judge Hand in *Morley* to "justify the departure from 'the rule conditioning subrogation on full payment by the surety' " is accepted by this appellee as a true and correct application of the equitable principle applied by the courts below to Seaboard. Indeed, the *Morley* language referred to by Seaboard (at p. 12) as "pertinent" further supports the courts below in distinguishing Seaboard as a surety that has security (i.e., recourse) other than the creditor's claim.

Until Seaboard can demonstrate to the Court that it has properly exhausted the letter of credit proceeds* and that its principal's estate is being enhanced at Seaboard's expense, it must abide by the rule that conditions subrogation on full payment by the surety.

POINT II

Seaboard's jurisdictional objections are illusory in view of the scope of the Bankruptcy Court's decision.

The procedural posture of this adversary proceeding has the effect of putting appellant Seaboard's jurisdictional cart before the substantive horse. As the District Court

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* Seaboard, on the appeal to the District Court, attempted to include in the Record a claim that the letter of credit proceeds have indeed been exhausted. Aside from the fact that Seaboard's claim has not been subjected to proof in any court, the claim itself is meaningless if the proceeds have been squandered or otherwise improperly or incorrectly applied. The Trustee and Harvester Credit prevailed on a motion to strike the Seaboard material from the record. Unabashed, Seaboard has included all of the motion to strike papers, including its claim, in the so-called "Joint Appendix", (to which appellee Harvester Credit's counsel's name was affixed without their knowledge or consent), despite the fact that Seaboard has not prosecuted its pro forma appeal from the order to strike.

distilled from the Bankruptcy Court's opinion:

> "The sole issue of substance resolved by the Bankruptcy Court and presently before this court for review concerns the effect of the proceeds of the letter of credit upon the claimed right of the surety, Seaboard, to invite set-offs by Eastern's shipping customers." (R 666a-67a)

That effect, said both courts below, was to defer Seaboard's set-off rights until the letter of credit proceeds were exhausted.

As Seaboard concedes in its brief (at p. 29), the jurisdictional objections of Seaboard are prospective in this case and are only germane if Seaboard's substantive position is not sustained. Seaboard does not contest the jurisdiction of the Bankruptcy Court to decide the setoff issue; it contends only that the setoff issue was wrongly decided.

Even so, Seaboard asks this Court, if the orders appealed from be affirmed, for a prospective jurisdictional opinion on substantive issues which have yet to be litigated by any party in any court. Both the Bankruptcy Court and the District Court were unwilling to prejudge issues which in their unanimous opinion should await an evidentiary hearing.

For Seaboard to support its request for a prospective opinion denying jurisdiction to the Bankruptcy Court by insinuating bias on the part of that Court is to engage in the very prejudging upon which the courts below frowned. What Seaboard really seeks here is to tie the hands of the Bangruptcy Court in administering the accounts receivable, for any purpose, by carving out in another court the extent of Seaboard's rights, if any, to those accounts.

If the Bankruptcy Court does indeed exercise jurisdiction on the substantive issues raised under the Collateral Agreement, the Agreement of Indemnity and the letter of

credit, it will do so (i) because it cannot otherwise establish how much of the Eastern accounts receivable, if any, are subject to Seaboard's setoff claims, pursuant, in part, to Section 57(e) of the Bankruptcy Act and (ii) because any right Seaboard has to a setoff arises from the fact that the letter of credit proceeds are properly applicable elsewhere in the bankruptcy proceeding, or have been exhausted in the payment of shippers' claims.

Seaboard attempts to distinguish the determination of its possible rights to setoff under the "same transaction" rule of *Daniel* v. *Guaranty Trust Co. of New York,* 285 U. S. 154 (1932) and, apparently, to claim that its rights in connection with the letter of credit proceeds arise from a different transaction than its duty to make a shipper whole. It is submitted that the transaction by which Seaboard claims any right of setoff is the issuance of its cargo bonds and the letter of credit which Seaboard concedes it insisted upon in that connection (Appellant's Brief p. 18). But for the issuance of the bonds, Seaboard would not be making setoff claims. But for the letter of credit, issued in connection with the bonds, the trustee would not be resisting the setoffs. By Seaboard's admission, the letter of credit is an integral part of the contract it made with Eastern and it would not have issued the bonds without the letter of credit. Certainly, the Trustee is entitled to enforce that contract in accordance with its terms and in accordance with the terms of the letter of credit. One cannot say that the Trustee's insistence on proper application of the letter of credit proceeds to shippers' claims before Seaboard's setoff claims are recognized is "unrelated". Seaboard appears for no purpose unrelated to shippers' claims, whereas in *Daniel,* the trustee used the appearance of the petitioning bank in a proceeding to reclaim bonds as the occasion to assert a counterclaim for unrelated funds deposited in the bank post-petition.

More to the point on the issue of summary jurisdiction is the landmark case of *Katchen* v. *Landy,* 382 U.S. 323

(1966) which definitively determined the extent of the Bankruptcy Court's summary jurisdiction under substantially similar circumstances.

This opinion furthermore addresses directly the basis of Seaboard's accusation of Bankruptcy Court bias and the basis for granting full relief between the parties and is accordingly quite relevant to this appeal. In discussing the question of whether, in adjudicating a Trustee's opposition to a creditor's claim filed in a bankruptcy proceeding by reason of the receipt by such creditor of a preference, the Bankruptcy Court possessed the summary jurisdiction to require the creditor, indisputably an adverse claimant as to the *res* of the preference, to return the preference to the Trustee, Mr. Justice White, writing for the majority, found that such Bankruptcy Court did indeed possess such summary jurisdiction, and said, at pp. 333-36 (15 L.Ed. 2d at 399):

> ". . . But once it is established that the issue of preference may be summarily adjudicated absent an affirmative demand for surrender of the preference, it can hardly be doubted that there is summary jurisdiction to order the return of the preference. This is so because *in passing on a § 57g objection the Bankruptcy Court must necessarily determine the amount of the preference, if any, so as to ascertain* whether the claimant, should he return the preference, has satisfied the condition of § 57g on allowance of the claim (emphasis supplied). *Schwartz & Levine* v. *Malin, Inc.*, 111 F. 2d 81 (CA2 Cir. 1940). Thus, once a Bankruptcy Court has dealt with the preference issue, nothing remains for adjudication in a plenary suit. The normal rules of res judicata and collateral estoppel apply to the decisions of bankruptcy courts. *Chicot County Drainage District* v. *Baxter State Bank*, 308 U.S. 371, 376-77; 84 L. Ed. 329, 333, 605 S. Ct. 317, *Stoll* v. *Gottlieb*, 305 U.S. 165, 83 L. Ed. 104, 59 S. Ct. 134. More specifically, a creditor who offers a proof

of claim and demands its allowance is bound by what is judicially determined *Wiswall* v. *Campbell,* 93 U.S. 347, 351, 28 L. Ed. 923, 924, and if his claim is rejected, its validity may not be relitigated in another proceeding on the claim *Sampsell* v. *Imperial Paper Corp.,* 313 U.S. 215, 218-219; 85 L. Ed. 1293, 1297, 61 S. Ct. 904; *Lesser* v. *Gray,* 236 U.S. 70, 75, 59 L. Ed. 471, 475, 38 S. Ct. 227. The Courts of Appeals have uniformly applied these principles to hold that a bankruptcy court's resolution of the § 57g objection is res judicata in a subsequent action under § 60 to recover the preference [citation omitted]. To require the Trustee to commence a plenary action in such circumstances would be a meaningless gesture and it is well within the equitable power of the bankruptcy court to order return of the preference during the summary proceedings on allowance and disallowance of claims. What we said in *Alexander* v. *Hillman,* 296 U.S. 222, 80 L. Ed. 192, 56 S. Ct. 204, in connection with the jurisdiction of a receivership court to entertain a counterclaim against a claimant in the receivership proceeding is equally applicable here

> 'By presenting their claims respondents subjected themselves to all the consequences that attach to an appearance . . . Respondents' contention means that while invoking the Court's jurisdiction to establish their right to participate in the distribution, they may deny its power to require them to account for what they misappropriated. In behalf of creditors and stockholders, the receivers reasonably may insist that, before taking aught, respondents may by the receivership court be required to make restitution. That requirement is in harmony with the rule generally followed by courts of equity that, having jurisdiction of the parties to controversies brought before them, they will decide all matters in dispute

and decree complete relief.' 296 U.S. at 241-242; 80 L. Ed. at 200, 201.

"Our examination of the structure and purpose of the Bankruptcy Act and the provisions dealing with allowance of claims therefore leads us to conclude, and we so hold, that the Act does confer summary jurisdiction to compel a claimant to surrender preferences that under § 57g would require disallowance of the claim."

In so doing the Supreme Court resolved a conflict among the circuits and, by implication and by name, reversed the line of cases including *B. F. Avery & Sons* v. *Davis* and *Gill* v. *Phillips*. Harvester Credit asserts that this opinion is directly on point, as the Bankruptcy Court properly noted. This case, like *Katchen* v. *Landy,* presents a creditor's claim which, if the Trustee-Harvester Credit position prevails, would be disallowed until the creditor complied with its contractual obligations, a condition precedent. This case, like *Katchen* v. *Landy,* presents an appellant who simultaneously seeks the affirmative protection of the Bankruptcy Court for its setoff claims and attempts to bar such Court from considering its inequitable conduct which disentitles it to such equitable relief without restitution. This case, like *Katchen* v. *Landy,* presents the situation where the exercise of jurisdiction is sought solely in order to resolve fully the legal claims of the parties arising out of the 1974 Agreements, including the rights, or lack thereof, of account setoffs rather than to drag in unrelated issues. This case, even more forcefully than *Katchen* v. *Landy* demands inclusion of the consideration of the letter of credit question, as that question is intimately entwined with the issuance of the bonds, while the receipt of the *Katchen* v. *Landy* preference need not have been so closely related. Moreover, since Seaboard stands in the shoes of a secured creditor subject to Section 57(e) of the Bank-

ruptcy Act, the Bankruptcy Court must, in the context of this proceeding, be allowed to exercise its jurisdiction to value Seaboard's security, vis a vis Eastern, if a setoff claim is to be found and allowed "for such sums only as to the courts seem to be owing over and above the value of [Seaboard's] security". Pursuant to Bankruptcy Rule 306(d) which states:

> "If a secured creditor files a proof of claim, the value of the security interest held by him as collateral for his claim shall be determined by the court, and the claim shall be allowed only to the extent it is enforceabe for any execss of the claim over such value",

neither Seaboard nor the account debtors to whom it would be subrogated pursuant to § 57(i) can ignore the existence of the letter of credit proceeds or its value in the hands of Seaboard. See 3 Collier on Bankruptcy ¶ 57.21 on secured sureties.

The question of the Bankruptcy Court's jurisdiction over parties asserting claims against a bankrupt estate has always been troublesome. In the present case, the Trustee and other interested claimants to certain assets of a bankrupt are attempting to enforce the rights of the bankrupt and a third party bank arising out of a series of 1974 agreements by reason of which Seaboard issued the Eastern cargo bond. Seaboard asserts that this Court may adjudicate the claim of Seaboard to take setoffs arising from the issuance of the bond, but not claims of the estate and others arising out of the balance of the same transaction—the issuance of the letter of credit, and the alleged Collateral Agreement and General Agreement of Indemnity. The difficulty posed by this bifurcated position is that it requires the Bankruptcy Court to split its jurisdiction and decide substantially less than all of the issues between the parties arising from the one single transaction.

Mr. Justice White in *Katchen* v. *Landy* spoke to precisely this sort of situation in his majority opinion but the courts below would await development of the issues by the parties.

It is respectfully submitted that while the facts and relationships appear to militate toward the exercise of jurisdiction by the Bankruptcy Court over the proper application of the letter of credit proceeds, no one can at this time predict with certainty how the issues will develop and whether the Bankruptcy Court would retain jurisdiction or suggest submission to the state courts for certain issues. For this Court to rule prospectively on the possible jurisdictional issues might well determine the substantive result before the facts are revealed.

Thus, it is urged that Seaboard's request for a prospective opinion in the event the appellees prevail on the substantive issue be denied.

POINT III

Seaboard has not met its burden of proof to show that no justiciable issue exists among the parties to this litigation; and the denial of Seaboard's motions to dismiss for failure to state a claim upon which relief may be granted was correct and should be affirmed.

Seaboard has on this appeal lost sight of the fact that the motion, denial of which is being appealed, is, in part, a motion to dismiss for failure to state a claim upon which relief can be granted. In order to prevail on such a motion, Seaboard must show that no genuine issues of fact remain among the parties and that Seaboard is entitled to judgment as a matter of law. The motion should not be granted unless it appears to a certainty that plaintiff is entitled to no relief under any state of facts which could be proved in support of the claim. *Haines* v. *Kerner*, 404

U.S. 519 (1972), or that such a claim is "wholly frivolous". *Radovitch* v. *N.F.L.*, 352 US 445, reh, den. 353 U.S. 931.

Summary judgment is only available to a movant when the movant is entitled to judgment as a matter of law, where it is quite clear what the truth is, and that no genuine issue remains for trial. *Sartor* v. *Arkansas Gas Corp.*, 321 U.S. 620. In considering such a motion, the well pleaded facts of the complaint and cross-claims are to be accepted as true. Absent the requisite showing, the motion must be denied. *McDonald* v. *Winfield,* 80 F. Supp. 939 (E.D. Pa. 1948).

Seaboard has failed to demonstrate as a matter of law that it is entitled to judgment either dismissing the complaint or for the affirmative relief requested. Seaboard relies exclusively on a single cause - - - *Yale Express* - - - which differs materially on its facts from the case before the Court:

— *Yale Express* involved a single bankrupt (in a Chapter X) and a single insurance company. This case involves two bankrupts and numerous subsidiaries of each and an alleged but not yet established claim of joint and several liability.

— *Yale Express* involved a stipulation between the parties as to a segregated fund, disposition of which would be determined by the action. There is no stipulation in this case.

— *Yale Express* involved unpledged accounts receivables, as far as the opinion recites. This case concerns accounts subject to both pre-petition and post-petition liens, and the lienors have all appeared and objected.

— *Yale Express* involved accounts collected without prejudice at all times as to waivers. In this case over $1.4 million in accounts receivable were paid without complaint by account debtors and without claim of set-

off as to sums paid, and a question in the case is whether such payment constitutes waiver of offsets and whether such waiver is enforceable against Seaboard.

— *Yale Express* turned on the issuance of simply the bond itself. This case turns on the effect of a Collateral Agreement and General Agreement of Indemnity unperfected in accordance with Article "9" of the Uniform Commercial Code, and the enforceability thereof.

— *Yale Express* involved the sending of a letter, quoted above, substantially reciting Section 68(a) of the Bankruptcy Act and no more. This case involves a very different letter not mentioning Section 68(a) and rather denying liability under the Seaboard cargo bond except for the excess of claims alleged but not proven over the amount of unpaid account receivable owed Eastern at April 22, 1976.

— *Yale Express* concerned proceeds of accounts which had been collected by the Trustee. This case concerns secret, tortuous interference by the surety with precisely such Trustee's collection efforts, under circumstances precluding the Trustee's collection and assertions of rights by cargo claimants and invitation of the most blatant frauds.

Seaboard cannot explain away the differences; nor, indeed, has it even attempted to do so. To grant Seaboard the relief it seeks would be to extend the rule of *Yale Express* on a complaint setting forth facts substantially and materially different from *Yale Express*.

POINT IV

The disposition of the proceeds of the letter of credit will have a financial effect on the Eastern estate.

Seaboard contends that the resolution of the letter of credit dispute will have no financial effect on the Eastern estate. A simple arithmetic exercise will demonstrate the fallacy of this statement.

If Harvester Credit's positions prevail, and Seaboard is found to have released its joint and several indemnity by failure to file claims against Associated until after the bar date, and the letter of credit is held to apply only to Eastern, the adjustment of claims will be as follows:

(1) Seaboard's claims will be satisfied as to liability to cargo and other bond claimants of Eastern out of the letter of credit, in cash. By reason of its release of Associated, Seaboard will have no Associated indemnity claims to file in the Eastern estate.

(2) All the Eastern cargo claimants will be paid in full and will pay the accounts receivable to a greater degree. This will increase the gross assets in the estate by the amount that cargo claimants, none of whom has been paid by Seaboard, are now withholding. The increase in the gross value of the estate will substantially affect the sum available for the satisfaction of all other claims.

(3) Chase's claim will have been reduced by the refund, if any, which it receives from Seaboard.

(4) Other lienors in the accounts will have had their claims satisfied or reduced by the accounts collected.

(5) An equity in the accounts may be realized for the estate proper.

Under these circumstances, the net gain to the estate would be (1) the elimination of Associated indemnity

claims, (2) increase in collection of assets available for payment of debts of the estate, (3) minimization of Chase's claim and the claims of other lienors on accounts, (4) possible realization of equity for the estate.

The fallacy in Seaboard's reasoning are the suppositions:

(1) That its conduct has had no effect other than as among Chase and itself. In truth, its own failure to pay cargo claims has diminished the assets available to the estate for the settlement of all claims because of withholding by cargo claimants of the entire sum outstanding, even if in excess of the cargo claim.

(2) That its claim to joint and several indemnity is invulnerable notwithstanding its release of Associated therefrom. Disallowance of that claim would materially reduce the dollar amount of all claims against the estate.

(3) That its claims stand on a parity with shippers' direct claims. Section 57(i) and Bankruptcy Rule 304 provide that a surety is not subrogated to a shipper's claim unless and until the creditor-shipper is paid in full. Seaboard has paid no shippers to date to the knowledge of Harvester Credit.

The fundamental difference between this case and the *First State Bank and Trust of Guthrie* case cited by Seaboard is even more pronounced if the existence of the proceeds are really irrelevant. Seaboard does not intend to share *pro rata* with Chase and other creditors in the Eastern estate, if any, but intends rather to satisfy itself at 100% of alleged but unproven claims out of assets of the estate or for which the estate is liable, leaving all these creditors to share in a smaller pot. This affects most profoundly the administration of the estate.

Since either analysis results in an effect upon the amount of assets coming into the estate and the means of

administration thereof, the administration of the estate is deeply affected by the determination of the letter of credit issue and Harvester Credit's other claims. *First State Bank and Trust Company of Guthrie* simply does not apply.

POINT V

The Courts below acted properly in enjoining Seaboard *pendente lite* from sending letters to account debtors of Eastern.

Seaboard has contended that *Yale Express* entitled it to send the letters from further dissemination of which the Bankruptcy Court has enjoined it *pendente lite*. Harvester Credit respectfully asserts that the issuance of such injunction was correct and should be affirmed.

The Bankruptcy Court was quite clear in its reasons for issuance of the injunction *pendente lite*. It took the position that Seaboard's "invitation to Eastern's accounts receivable debtors to set off a fixed liability against Seaboard's evaluation of cargo damage claims . . . gives those debtors the exclusive right to set off whatever they wish, whether justified or not, a tender treatment not usually afforded by diligent trustees". (R 541a) Nor by a diligent Bankruptcy Court.

Under Section 2(a)(15) of the Bankruptcy Act, the Bankruptcy Court has the original jurisdiction to "(15) Make such Orders, issue such process and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act . . . ." This so called "all writs" section grants to the Bankruptcy Court the power to issue such orders as it deems necessary to enforce the provisions of the Bankruptcy Act. One of the provisions of that Act is Section 70(a), the section under which accounts receivables

of a bankrupt pass to the Bankruptcy Court and thence to the trustee in bankruptcy for administration. Bankruptcy Rules 401 and 601 specifically and automatically preclude claimants against a bankrupt from taking certain steps against the bankrupt's assets. Other creditors claiming the Eastern accounts acknowledged that they were bound by these stays and asserted quite fairly that they would be unduly prejudiced if one claimant, Seaboard, were, without blessing of the Bankruptcy Court, permitted to ignore the stay and play havoc with collectibility of receivables. Seaboard appeared in the first injunction proceeding and acknowledged that it believed itself protected by *Yale Express* and not bound by any stay. Under these circumstances, the first injunction issued, Seaboard abandoned its appeal against imposition of that injunction, and the order granting that injunction became final and is now *res judicata* against Seaboard.

Subsequently, the Bankruptcy Court, in responding to Seaboard's motion to dismiss, made that injunction "permanent", or until the earlier occurrence of certain events.

For these reasons and the reasons set forth in Point IV above, the injunction should be affirmed.

CONCLUSION

The orders of the District Court and the Bankruptcy Court should be affirmed in all respects.

Dated: February 28, 1978

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In Re
EASTERN FREIGHT WAYS, INC.,
Bankrupt,

SIDNEY B. GLUCK, Trustee in Bankruptcy of EASTERN FREIGHT WAYS, INC.,
Plaintiff-Appellee,

against

SEABOARD SURETY COMPANY,
Defendant-Appellant,
MANUFACTURERS HANOVER TRUST CO. et al.,
Defendants-Appellees.

State of New York,
County of New York,
City of New York—ss.:

DAVID F. WILSON being duly sworn, deposes and says that he is over the age of 18 years. That on the 28th day of February, 1978, he served two copies of Brief of Appellee International Harvester Credit on Wickes, Riddell, Bloomer, Jacobi & McGuire and on Tell, Cheser, Breitbart & Lefkowitz, the attorneys for Defendant-AppellantSeaboard Surety Company by delivering to and leaving same with a proper person in charge of their office at 59 Maiden Lane and 116 John Street, respectively in the Borough of Manhattan, City of New York, between the usual business hours of said day.

David F. Wilson

Sworn to before me this
28thday of February, 1978.

Courtney J. Brown

COURTNEY J. BROWN
Notary Public, State of New York
No. 31-5472920
Qualified in New York County
Commission Expires March 30, 19

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the attorneys for ~~the~~ see attached list by depositing the same, properly enclosed in a securely sealed post-paid wrapper, in a Branch Post Office regularly maintained by the Government of the United States at 90 Church Street, Borough of Manhattan, City of New York, directed to said attorneys at No. see attached list ( ) N. Y., that being the address designated by them for that purpose upon the preceding papers in this action.

David F. Wilson

Sworn to before me this
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